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CHARLES ELMORE CRO
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 354

In the Matter

of

UNITED CIGAR STORES COMPANY OF AMERICA,
Debtor.

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as trustees,
Petitioners,

GRAYSON M.-P. MURPHY, *et al.*, as a Preferred Stockholders Protective Committee, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

ROLLIN BROWNE,
RALPH MONTGOMERY ARKUSH,
HENRY L. GLENN,
Counsel for Petitioners.

MITCHELL, TAYLOR, CAPRON & MARSH,
Of Counsel.

THE COURT PRESS, N. Y. C.

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CAROLINE R. KUEHNER and FREDERICK G. FISCHER,
as trustees,
Petitioners,

GRAYSON M.-P. MURPHY, *et al.*, as a Preferred Stockholders Protective Committee, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the Honorables, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The petitioners respectfully submit their petition for a writ of certiorari to review the decision of the United States Circuit Court of Appeals for the Second Circuit in the above case.

SUMMARY STATEMENT OF MATTER INVOLVED

This case involves the interpretation and constitutionality of the limitation on landlords' claims under Section 77B of the Bankruptcy Act (*infra*, p. 11).

The petitioners are creditors of United Cigar Stores Company of America, the debtor in corporate reorganization proceedings under Section 77B. Their claim arises out of a lease of real estate which had been rejected by the debtor's trustee in bankruptcy proceedings antedating the 77B proceedings. Under the lease covenant the petitioners are entitled to indemnity from the debtor against all loss of rent during the period of fourteen years between the termination of the lease by reentry in 1932 and the expiration of the stipulated term in 1946. Under the law of its state of incorporation in case of a winding up of the debtor, the claim of the petitioners would be recognized to its full extent in priority to any interest of stockholders. There has been no determination that the debtor is insolvent. Nevertheless, the Court of Appeals has decided that—irrespective of how large may be the participation accorded to stockholders—the petitioners' right to participate in the reorganization is limited to the arbitrary amount specified in clause (10) subdivision (b) of Section 77B (referred to herein as "three years rent"). Such amount is concededly less than the difference between the future rent payments, discounted, and the appraised value of the remaining term. The court below refused to allow the balance of such difference over three years rent in subordination to debts provable under Section 63(a) of the Act (herein referred to as "provable debts"), or to interpret the statute as requiring the preservation of the petitioners' rights in priority to stockholders to the extent they may turn out to exceed three years rent.

FACTS

The petitioners' predecessors leased to the debtor premises in New Jersey for a term commencing in 1926 and expiring in 1946, at a net annual rental of $10,500 for the first ten years and $11,500 thereafter (R. 46). On August 29, 1932, the debtor filed its voluntary petition in bankruptcy, was adjudicated and abandoned the premises. On November 14, 1932, the trustee in bankruptcy rejected the lease and abandoned the premises and on the following day the landlords re-entered (R. 6, 40), thus terminating the lease (R. 57). The lease obliged the debtor in such event to indemnify the landlords against all loss of rent which the landlords might incur by reason of such termination during the residue of the term (R. 57).

The debtor's petition for reorganization under Section 77B was filed in the bankruptcy proceedings on June 9 and approved on June 14, 1934. The petitioners filed a proof of claim (R. 4) praying that their claim "based upon or arising out of the lease * * * or for injury resulting from the rejection of said lease by the Trustee in Bankruptcy * * * or for damages or indemnity under a covenant or covenants contained in said lease", measured by the difference between the rent reserved and the rental value for the remainder of the term, be allowed on a parity with provable debts to the extent of three years rent and that the balance be allowed in subordination to provable debts but in priority to the claims or interests of the stockholders of the debtor.

The reorganization trustee objected, asking that the claim be reduced to an amount "limited as provided by the statute" (R. 15).

At the hearing, committees representing preferred stockholders and debentureholders of the debtor objected to the allowance of the claim in any amount

(R. 21) on the ground that the petitioners could not sue on the covenant of indemnity until the expiration of the term. Thereupon the petitioners amended the proof of claim so as to pray that, to the extent that any part of the claim should be held not provable, a charge be reserved against the debtor's assets, at least in priority to any interest accorded to stockholders (R. 25).

The fair rental value of the premises for the balance of the term is $111,545.36 (R. 73). The expert testimony establishing this value was not controverted. The future installments of rent under the lease for the remainder of the term aggregate $199,237.66.

RULINGS BELOW

The Special Master recommended (1) that the claim should be allowed on a parity with provable debts to the extent of three years rent, to wit, $44,377.55 and (2) that all questions as to the balance of the claim should be reserved until the time of the classification of creditors and stockholders and the consideration of a reorganization plan (R. 93).

The District Court confirmed the Special Master's report with the exception that the extent of the petitioners' right to participate in the proceedings was limited to the amount of $44,377.55 (R. 116, 146).

On cross appeals, the Court of Appeals affirmed, holding (R. 150): (1) that the claim should be liquidated "by discounting the future payments and subtracting the appraised value of the term from their sum" (R. 152);* (2) that the claim as so

* All questions as to discount were reserved for future determination of the District Court. However, the instant claim would exceed three years rent, even if discounted on any reasonable basis.

liquidated was presently allowable up to the amount of three years rent; (3) that the limitation provision of the statute was intended to limit the petitioners' participation, as against stockholders as well as creditors, whether by way of allowance of a claim or reservation of rights; and (4) that the limitation provision, as so interpreted, was constitutional, because of supposed difficulties in liquidating the claim and because the pre-existing rights of the petitioners, of which they were deprived by the statute, were considered to be of no practical value.

QUESTIONS PRESENTED

1. Should the limitation provision be interpreted as limiting only the amount in which the petitioners' claim is allowable on a parity with provable debts, permitting the balance of the claim to be allowed in priority to the interest of stockholders?

2. If the balance of the claim is not presently allowable, does the statute preserve the residual rights of the petitioners in priority to the interest of stockholders?

3. If the statute is interpreted as limiting the petitioners' rights to a claim for three years rent, even although stockholders participate in the reorganization, is the statute to that extent unconstitutional as beyond the power of Congress under the bankruptcy clause and in contravention of the Fifth and Tenth Amendments?

The question of the constitutionality of the limitation provision was raised below (R. 28, 96-7, 123).

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. It is of public importance that doubts as to the meaning and constitutionality of the limitation provision be settled. Questions arising under other portions of Section 77B have been considered of sufficient public importance to justify review by this Court on certiorari.*

Landlords' claims constitute a large part of the claims pending against corporate debtors now in process of reorganization under Section 77B. In the present proceedings the amount of landlords' claims filed far exceeds the total amount of all other claims, and many of such claims, involving amounts in excess of three years rent, are awaiting the outcome of this case, in which the petitioners are represented by counsel for the Landlords' Protective Committee. Landlords' claims are especially frequent in cases of chain store corporations many of which, as has been publicly noted,** resorted during the recent depression to bankruptcy proceedings primarily for the purpose of escaping the burden of long term leases, and 77B proceedings have been instituted in many such bankruptcy proceedings.***

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* *Meyer* v. *Kenmore Granville Hotel Co.*, 296 U. S. 565; 297 *id.* 160; *Tuttle* v. *Harris*, 296 U. S. 567; 297 *id.* 225; *Callaghan* v. *Reconstruction Finance Corp.*, *Stitt* v. *Same*, 296 U. S. 570; 297 *id.* 464; *Duparquet Huot & Moneuse Co.* v. *Evans*, 296 U. S. 569, 297 *id.* 216; *Foust* v. *Munson S. S. Lines*, 80 L. Ed. 746; *Tennessee Publishing Co.* v. *Am. National Bank*, 80 L. Ed. 957.

** 42 Yale L. J. 1003; 33 Col. L. Rev. 231-4; 7 Univ. of Cinn. L. Rev. 164-5; see also the remarks of Representative Celler on the floor of the House (76 Cong. Rec., Pt. 2, p. 1360), with regard to the debtor in the case at bar.

*** The extent to which reorganization proceedings have been resorted to by chain store corporations is indicated by the following partial list of such corporations which are now in reorganization under Section 77B in the Southern District of New York alone: Schulte Retail Stores Corporation; D. A. Schulte

The difficulty of the questions presented is shown by the inconsistent interpretations of the statute advanced below by the various objectants. The trustee has contended that Congress intended to give the petitioners an allowable claim not in excess of three years rent in full satisfaction of their contract rights. The Debentureholders' Protective Committee has urged that Congress intended the petitioners to be held to the terms of their contract which entitled them to indemnity only at the expiration of the term of their lease. The Preferred Stockholders' Protective Committee has urged that the petitioners have no presently allowable claim, but that, nevertheless, Congress has limited their right to seek indemnity at the end of the term.

2. The questions presented are novel. So far as is known, the limitation provision is the first attempt of any legislature under any system of jurisprudence to limit the claims of a single class of creditors of an embarrassed debtor by an arbitrary formula bearing no relation to the creditor's real injury and of no utility in liquidating his claim. And when, as here, such provision is held to extinguish part of the creditors' rights for the benefit of the debtor's stock-

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Inc. of New York; D. A. Schulte, Inc. of Delaware; Huylers, Inc. of Delaware; Huyler's, New York; Schulco, Inc.; H. L. Green Co.; Bellcamp Stores, Inc.; Diamond Brothers Apparel Corp.; Steuben Taverns; Liberty Baking Corp.; Sunnydale Food Stores, Inc.; Highland Dairy Co.; Albrecht's Stores, Inc.

Some of such corporations which are in reorganization under Section 77B in other districts are as follows: Burg Company (Minn.); H. Winer Co. (Boston); Pollyanna Stores, Inc. (Conn.); Grant Lunch Corp. (Newark, N. J.); Donahoe's Inc. (Pittsburgh, Pa.); Gross Stores, Inc. (Phila., Pa.).

In recently pending reorganization proceedings of two large corporations similar questions regarding landlords' claims were also presented, but such claims were disposed of by compromise: Paramount Publix Corp. (S. D. N. Y.) and J. G. McCrory Co. (S. D. N. Y.).

holders, such legislation introduces an anomaly into the established Anglo-American law of debtor and creditor.

There is no analogy in prior bankruptcy legislation or in other provisions of the Bankruptcy Act now in force. The remark of this Court in *Louisville &c. Bank* v. *Radford,* 295 U. S. 555, 582, that no bankruptcy act had ever before undertaken to supply the bankrupt capital with which to engage in business in the future is applicable to Section 77B which, as construed below, transfers to the stockholders of the debtor an interest of substantial value belonging to the landlord creditors.

The former exclusion of landlords' claims of certain types from provability in bankruptcy in any amount furnishes no precedent. Claims not provable were not dischargeable, nor could the stockholders of the bankrupt corporation enrich themselves at the expense of the holders of non-provable claims by going through the formality of a bankruptcy sale and vesting the assets in a new company (see Landlords' Claims in Reorganization, 42 Yale L. J. 1003, 1015-1026).

Nor are the questions here discussed raised by the existing provisions for the relief of individual debtors (Section 74), railroad corporations (Section 77) and municipal corporations (Section 80). In none of those sections is there an attempt to limit landlords' claims.

The statute as interpreted below overturns established legal principles under which the rights of creditors, however contingent their claims may be, have hitherto enjoyed full protection in priority to stockholders (*Pierce* v. *United States,* 255 U. S. 398;

Northern Pacific Ry. Co. v. *Boyd,* 228 U. S. 482; *Block* v. *Bell Furniture Co.,* 111 N. J. Eq. 551).

3. The decision below departs from the principles established by the decisions of this Court in various respects, as shown in the annexed brief.

For the above reasons, the petitioners respectfully pray that a writ of certiorari issue to review the decision below.

Dated, September 4, 1936.

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as Trustees,

By ROLLIN BROWNE,
RALPH MONTGOMERY ARKUSH,
HENRY L. GLENN,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the District Court (per Knox, *D. J.*) appears at page 146 of the record and is not officially reported. The opinion of the Court of Appeals (per L. Hand, *C. J.*) appears at page 150 of the record and is not yet officially reported.

JURISDICTION

Jurisdiction to issue the writ is vested in this Court by Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. The order for mandate was entered on July 20, 1936.

STATEMENT OF THE CASE

The facts, rulings of the courts below and questions presented are set forth in the foregoing petition.

STATUTE INVOLVED

Section 77B of the Bankruptcy Act (48 Stat. 911) provides:

> "Sec. 77B. Corporate Reorganizations * * *.
>
> (b) * * * (10) * * * The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts * * * or other interest of whatever character. * * *

In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry. * * *

(h) Upon final confirmation of the plan, * * * the property dealt with by the plan * * * shall be free and clear of all claims of the debtor, its stockholders and creditors, except such as may consistently with the provisions of the plan be reserved * * *. Upon the termination of the proceedings a final decree shall be entered * * *. Such final decree shall discharge the debtor from its debts and liabilities, and shall terminate and end all rights and interests of its stockholders, except as provided in the plan or as may be reserved as aforesaid. * * *"

(Act approved June 7, 1934, 48 St. 911, Ch. 424, §1; U. S. C. Tit. 11, §207.)

SPECIFICATION OF ERRORS

The Court of Appeals erred in holding:

(1) that the limitation provision prohibited the allowance of the balance of petitioners' claim over three years rent in subordination to provable debts but in priority to the interest of stockholders;

(2) that the limitation provision prohibited the preservation of the petitioners' residual rights in priority to the interest of stockholders;

(3) that the limitation provision as so interpreted was a valid exercise of the bankruptcy power and did not violate the Fifth Amendment;

(4) that the petitioners had no standing to complain that other landlord creditors similarly situated would receive more favorable treatment than the petitioners as a result of the operation of the limitation provision as so interpreted.

SUMMARY OF ARGUMENT

Before the enactment of Section 77B the debtor had become obligated to the petitioners on the covenant of indemnity. The petitioners were, therefore, creditors, entitled to priority over the debtor's stockholders, and their contract rights constituted property within the protection of the constitutional guarantees. Moreover, the lease had been rejected by the trustee in bankruptcy.

Congress contemplated that in such a situation the petitioners' claim should be presently ascertained by some judicial method and allowed on a parity with provable debts up to an amount not in excess of three years rent, and that the balance, if any, of their

claim should be allowed in subordination to provable debts, but in priority to the interest of stockholders.

If the statute does not contemplate the subordinate allowance of such balance of the claim, then it requires that the debtor's liability under the covenant of indemnity, to the extent that it turns out to exceed the amount in which the claim is presently allowed, must be reserved, either in the plan or by order of the court, in priority to any interest accorded to the debtor's stockholders on the reorganization.

If the statute is construed as entirely freeing the debtor and its assets from liability to the petitioners in excess of three years rent, for the benefit of the debtor's stockholders, the statute is to that extent unconstitutional, as not falling within the bankruptcy power and as violating the Fifth and Tenth Amendments.

POINT I.

The balance of the petitioners' claim over three years rent is allowable in subordination to provable debts, but in priority to the interest of stockholders.

Even though before the enactment of Section 77B the petitioners' rights were contingent and unliquidated, the petitioners were creditors. Their right to priority over stockholders could not be displaced by discharge in bankruptcy; or by voluntary liquidation (*Pierce* v. *United States,* 255 U. S. 398); or by insolvency or winding up proceedings under the law of the state of incorporation (*Block* v. *Bell Furniture Company,* 111 N. J. Eq. 551); or by any form of reorganization (*Northern Pacific Railway Company* v. *Boyd,* 228 U. S. 482; *Howard* v. *Maxwell Motor Co., Inc.*, 269 Fed. 292, aff'd 275 Fed. 53; see Landlords'

Claims in Reorganization, 42 Yale L. J. 1003, 1015-1026).*

No statute theretofore enacted "for the relief of debtors" or for any other purpose had attempted to upset the established principle under which even contingent creditors are protected as against stockholders (*Kalkhoff* v. *Nelson,* 60 Minn. 284; *In re Mechanics Trust Co.,* 119 N. J. Eq. 141; *Block* v. *Bell Furniture Co., supra*; see also Sec. 425, N. Y. Insurance Law). The language, legislative history and underlying purpose of Section 77B indicate that Congress had no intention of attempting to upset these established rules.

A. *The language and legislative history.*

The general structure of the Act supports the interpretation that the limitation provision limits only the part of the claim allowable on a parity with provable debts. Subdivision (b) defines "creditors" as including "all holders of claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act" and defines "claims" as including "debts * * * or other interest of whatever character". The statute then specifically provides that any person injured by the rejection of an unexpired lease in the reorganization proceedings or in prior proceedings shall "for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor." These provisions clearly establish the landlord's status as a creditor to the full extent of his injury, damages or right to indemnity, and that

* *Block* v. *Bell Furniture Co.* and *Howard* v. *Maxwell Motor Co.* involved landlords' claims for loss of future rent.

status should be restricted only if and to the extent required by other equally clear and unambiguous language. There is no language anywhere in the statute which, in express terms, limits the landlord's status as a creditor. The succeeding sentence containing the limitation provision was not required in order to make the landlord a creditor or to entitle his claim to recognition, but only to fix the relative rank of his claim as compared with other claims.* Therefore, it should not be interpreted as restricting his general status as a creditor. Indeed, the fact that the limitation provision requires that the landlord's claim be treated on a parity with provable debts, subject to limitation in amount, indicates the intention of Congress that the balance of the claim, if any, be accorded subordinate treatment, since nowhere else in the statute is rank or priority prescribed (except the priority of certain unsecured claims over mortgages). If landlords' claims are limited for all purposes, the provision for parity is useless verbiage, as the Court of Appeals admits (R. 153).

The legislative history also supports the interpretation here urged. The bill, as originally passed by the House, allowed landlords' claims in full (H. R. 5884, June 2, 1933, p. 10). As passed by the Senate the bill provided that a landlord's claim should "not be treated as a claim ranking on a parity" with provable debts "except up to an amount equal to" one years rent, but that the balance, if any, of the claim should "be subordinated in rank to debts so provable" (H. R. 5884, May 7, 1934, p. 11). The only point of difference was the amount allowable on a parity,

* The language of the limitation provision originally adopted by the Senate (quoted above in the last paragraph of this page) bears this out.

neither house having suggested the destruction of any part of the claim. If the provision finally enacted be interpreted as limiting only the parity portion, it represents a fair compromise between the positions of the two branches of Congress.

The word "limited" appears for the first time in the final draft of the bill, but its meaning is clarified by the reports of the Conference Committee. That committee first recommended a clause providing that a landlord's claim should "be treated as a claim ranking on a parity with" provable debts "in an amount equal to" three years rent (73rd Cong., 2d Sess., H. R. Rep. No. 1773, p. 2). The House Managers described the effect of this provision as *limiting* rent claims "to an amount not to exceed" three years rent, but they also described the Senate bill as having *limited* rent claims (*ibid.*, p. 5), so that they must have meant in both cases only to refer to a limitation of the parity portion. In the amendment agreed upon in their second report the Conferees substituted the words "but shall be limited to an amount not to exceed [three years rent]" for the words "in an amount equal to [three years rent]" (H. R. No. 1821, p. 2). The words "limited to an amount not to exceed" were the exact language used by the House Managers in explanation of the amendment agreed upon in the first report. Again the word "limited" must have referred only to the parity portion, for in the second report the House Managers again used this word in referring to the original Senate enactment as well as to the provision then recommended, which was finally enacted. Had the Conference Committee intended in either its first or second report to recommend so radical a change from the Senate bill as destroying the non-parity portion of the claim, it is reasonable

to assume that the House Managers would have so stated.

As a matter of fact, the change recommended in the second Conference Report was desirable in order to make clear that a landlord's claim was not to be allowed on a parity "in an amount equal to" three years rent in case the total injury or damage actually proven was less than that amount.

The Court of Appeals ignored the circumstances just described because of the significance which it attributed to the omission from the final bill of the clause contained in the Senate bill expressly subordinating the balance of the landlord's claim over one years rent to provable debts (R. 153). That clause provided merely for the *subordination* of the excess claim, *not for its allowance*; it was mere surplusage, since without its inclusion the balance of the claim over one years rent was required to be subordinated to provable debts, in view of the express provision that the claim should not be allowed on a parity with provable debts, except up to an amount equal to one years rent. The fact that its omission was first recommended in the first Conference Report, which obviously referred to a limitation only of the parity portion, demonstrates that the omission did not have the significance attributed to it.

B: *The underlying purpose of the statute.*

The purpose of the statute was to provide a practical means of enabling embarrassed corporations to continue business in reorganized form. To this end, the definition of creditors is couched in broad terms and the statute provides, in subdivision (h), that the debtor and its assets shall be freed of all liabilities except such as may be specially reserved (*supra,* p. 12). To construe the statute as not providing for the

reservation in priority to stockholders of any valid claims not presently allowable would, as we show below (p. 23), raise grave doubts of its constitutionality. But the attainment of the dominant purpose of the statute—effective reorganization—requires that, so far as practicable, claims should be presently liquidated and allowed, rather than reserved. Therefore, it is not likely that Congress, which undoubtedly knew of the existence of the large lease obligations of many embarrassed corporations, intended that such obligations should be provided for by reservation rather than by present allowance.

C. *The method of liquidation adopted is sufficiently reliable to support the allowability of the entire claim.*

The formula adopted by the Court of Appeals for the measurement of the petitioners' claim—the difference between the total rent reserved, discounted, and the appraised value of the remaining term—is the only method ever followed or even suggested for determining damages for loss of future rent* and is the method uniformly used by the English courts** under the similar provisions of the English bankruptcy statutes,*** irrespective of the type of covenant con-

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* *Leo* v. *Pearce Stores Co.*, 54 F. (2d) 92, 57 F. (2d) 340; *McGraw* v. *Union Trust Co.*, 135 Mich. 609; *Kalkoff* v. *Nelson*, 60 Minn. 284; *In re Reading Iron Works*, 150 Pa. St. 369; *Curran* v. *Smith-Zollinger Co.*, 18 Del. Ch. 220.

** *Ex Parte Blake*, 11 Ch. Div. 572; *Ex Parte Llynvi Coal & Iron Co.; In re Hide*, L. R. 7 Ch. App. 28; *Ex Parte Leather Sellers' Co.*, 3 Morrell 126; *In re Panther Lead Co.* [1896] 1 Ch. Div. 978; *In re Carruthers*, 15 Reports 317, 2 Mansons 172.

*** 4 and 5 Geo. V., c. 59; 46 and 47 Vict., c. 52, Sec. 55(7).

> "We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system. * * *" (*Sexton* v. *Dreyfus*, 219 U. S. 339, 344; see also *Willis* v. *Eastern Trust and Banking Co.*, 169 U. S. 295, 307.)

tained in the lease. It is a basis "familiar and fair" when agreed to by the parties (*William Filene's Sons Co.* v. *Weed*, 245 U. S. 597, 602) and "the best means at hand" (*Manhattan Properties, Inc.* v. *Irving Trust Co.*, 66 F. [2d] 470, 471). Nevertheless, the Court of Appeals felt that the method is not entirely reliable, due to the difficulty of prophesying the "future value" of realty (R. 153).

But the rental value of real property for a future term is a present fact, not depending on prophecy or future valuation. The problem is merely to ascertain the amount for which the property could be rented *at the present time* for a given term of years. In some cases expert testimony must be resorted to, but that does not depend on the gift of prophecy; it represents, rather, an opinion of one qualified to speak as to a present fact. And expert opinion is not the only or always the best evidence of rental value: if the landlord, exercising reasonable diligence, has succeeded in re-renting the property for the balance of the term, that fact would constitute the best evidence (*Curran* v. *Smith-Zollinger Co., supra*).

This Court will take judicial notice that leases of real property are made every day in the ordinary course of business. Every such lease is made for a future term and many are made for very long terms.* A fact which business men ascertain and rely on every day in the course of their usual business activities cannot be as unreliable as the Court of Appeals appears to consider it.

The method of liquidation adopted does not involve an attempt to forecast either the amount of rents which a landlord will lose over the remainder

* The petitioners' predecessors and the debtor in the case at bar made such a deal in 1926 when one agreed to pay and the other agreed to accept an average annual net rental of $11,000 for the property here involved, over a period of twenty years.

of the term, or what the rental value of the property for shorter periods would be at different dates over the remainder of the term. As the Court of Appeals said, the same measure must be used as in cases of breach of an executory contract for chattels, or the claim cannot be measured at all. The computation of damages in such cases is not influenced by the probability that the actual loss may turn out to be greater or less, or even by the known fact that, because of some circumstance intervening the breach and the award, the predicted loss has actually been turned into a profit (*In re Susquehanna Silk Mills*, 10 F. Supp. 787, aff'd 77 F. [2d] 1015).

Congress did not "circumscribe" the use of the formula to "the near future" or fix a period of "four or five years" "as the maximum forecast which it would be safe to act on", as the Court of Appeals said Congress *might have done* (R. 153-4). On the contrary, the statute, even as interpreted by the Court of Appeals, requires the formula to be used in respect of the entire balance of the term, however long that may be, and requires that the result be adhered to, provided it does not exceed the arbitrary maximum. If the formula had produced a result less than three years rent, the petitioners would have been bound by it.

POINT II.

If the balance of the claim over three years rent is not presently allowable the statute requires that the petitioners' rights under the covenant of indemnity, to the extent they turn out to exceed the amount of the allowed claim, be preserved in priority to stockholders.

Even if the Court of Appeals were correct in holding that the balance of the claim over three years rent was not presently allowable, that would not require or even support the conclusion, to which the Court of Appeals passed without discussion, that the petitioners' rights were intended to be extinguished for the benefit of stockholders. The limitation provision at the very most relates only to the *allowability* of *claims.* Other provisions of the statute (*supra,* p. 12) expressly recognize that some *liabilities* must be *reserved.* There is not one word in the statute which requires the discharge of a landlord's claim over three years rent *for the benefit of stockholders,* or which forbids its reservation *in priority to stockholders.*

Finally, if the entire claim is not presently allowable, the interpretation which we are now urging is required in order to avoid raising grave doubts as to the constitutionality of the statute (*Interstate Commerce Comm.* v. *Oregon-Washington R. & Nav. Co.,* 288 U. S. 14; *Linder* v. *United States,* 268 U. S. 5) and to avoid the harsh and arbitrary inequalities produced by a contrary interpretation* (*Knowlton* v. *Moore,* 178 U. S. 41, 76-77; *United States* v. *Kirby,* 7 Wall. 482, 486). The Court of Appeals itself expressed doubts as to the constitutionality of the stat-

* See *infra,* page 26.

ute as applied to certain landlords' claims (R. 156). The limitation provision is not divisible; it was designed to apply alike to all landlords' claims. Thus these admitted doubts require the interpretation here urged (*cf. Illinois Central R. R. Co.* v. *McKendree,* 203 U. S. 514, 528; *The Employers' Liability Cases,* 207 U. S. 463, 496-501, 504).

POINT III.

The limitation provision, as interpreted by the Court of Appeals, is unconstitutional.

Congress was without power to deprive the petitioners of their fundamental rights as creditors for the benefit of stockholders. The bankruptcy clause of the Constitution authorizes no such legislative repeal of fundamental law and, even if within the general scope of the bankruptcy power, the attempted exercise of the power falls under the prohibition of the Fifth Amendment.

A. *The bankruptcy clause.*

While it is conceded that the bankruptcy power of Congress extends to whatever is necessary or reasonably adapted "under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors" (*Campbell* v. *Alleghany Corp.* 75 F. [2d] 947, 955, cer. den. 296 U. S. 581), the arbitrary extinguishment of a portion of landlords' claims for the benefit of stockholders cannot be supported as a valid exercise of that power.

There was nothing in the practical situation with which Congress was dealing in the enactment of Section 77B (see *Duparquet etc. Co.* v. *Evans,* 297 U. S. 216) which required the legislative repeal of the

fundamental principle that the priority of creditors (however contingent their claims may be) over stockholders could not be evaded by any form of corporate reorganization (*Northern Pacific Ry. Co.* v. *Boyd, supra; Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445; *Howard* v. *Maxwell Motor Co., Inc., supra*). The Court of Appeals itself has recognized the controlling effect of the *Boyd* case in reorganization proceedings under Section 77B (*In re New York Railways Corp.*, 82 F. [2d] 739).

Even if the inherent nature of claims justifies their partial exclusion from present allowability on a parity with other debts, that does not necessitate the extinguishment of the unallowable portion of the claims for the benefit of stockholders. Contingent claims may be allowed in subordination to other debts or reserved in priority to the interest of stockholders and corporations may be reorganized effectively without according stockholders a participation at the expense of a single class of creditors.

Nor is the provision reasonably adapted to the object in view—effective reorganization. There is no relation whatever between the amount of three years rent (fixed many years ago) and the present value of an agreement to indemnify against loss of rents during a term which, as in the case at bar, has fourteen years to run. The limitation provision does not provide a method of liquidation of landlords' claims, but requires an actual ascertainment of the total claim before the limitation, whatever it may mean, may be applied.*

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* Compare *Norman* v. *B. & O. R. Co.*, 294 U. S. 240, in which the abrogation of private contracts was upheld as reasonably adapted to the effective exercise of certain powers of Congress, with the exercise of which such contracts interfered.

The only ground on which the Court of Appeals thought the limitation to three years rent had a "rational relation to the end to be achieved" was that it ordinarily would permit a landlord to prove his losses for "four or five years" which the Court thought was "a period which Congress *might* well fix as the maximum forecast which it would be safe to act on" (R. 154). To this assumption there are several answers: (1) the limitation provision does not restrict the liquidation of landlords' losses to any particular period; (2) the liquidation of landlords' claims does not involve forecasting *future* values of real estate; (3) other claims equally or more difficult of liquidation are allowable in full; and (4) if claims may not be liquidated properly, there is no reason for extinguishing them for the benefit of stockholders.

B. *The due process clause.*

The Court of Appeals failed to understand the precise ground of the petitioners' attack on the constitutionality of the statute under the due process clause, saying (R. 153) that the petitioners' position "presupposes that the appraisal of the future value of real estate is so reliable a basis * * * that Congress was obliged to treat it as good against shareholders."

The petitioners did not urge that the statute was unconstitutional if not requiring the present allowance of the entire claim measured by the formula adopted or by any other formula. (It should be noted that the court and not Congress prescribed the use of the formula.) The petitioners' position is that, if their claim is not presently allowable in excess of three years rent, then the failure of the statute to preserve as against stockholders their right

to indemnity, to the extent that it turns out to exceed three years rent, renders the statute unconstitutional. Their complaint is that their contract rights have been appropriated by legislative decree for the benefit of the stockholders, and that the "truncated substitute" measured by a "piepowder standard" is arbitrary, discriminatory and not compensatory.

(1) The limitation provision is arbitrary and discriminatory.

The inequalities and arbitrary discrimination produced by the statute are not incidental, occasional or only remotely possible, but "inevitable and profound" (*Knowlton* v. *Moore, supra*).

It is only theoretically possible—and then only by purest accident—that the provision can operate equally as among landlords similarly situated. As the table printed on the opposite page shows, the provision may—almost must—operate unequally between two landlords even where the amounts of three years rent are identical; even where the unexpired terms of the leases are identical; even where the rental values of the properties are identical; and even where any two of these three elements are identical, or where the total damages, or the respective ratios of total damage to total rent reserved, are identical.*

In every case, irrespective of the identity of all other factors, the determining factor is three times the amount of the annual rent which happens to have been agreed upon when the lease was made, perhaps many years ago. Under that standard, one landlord's loss may be allowed for five years while the losses

* Similar inequalities result if the landlord's damage is considered to be, not the difference between rental value and rent reserved, but the actual loss ascertained at the end of the term.

	A		B		C		D		E		F	
Unexpired term	10 yrs.		10 yrs.		10 yrs.		6 yrs.		4 yrs.		4 yrs.	
Annual rent	$10,000		$10,000		$12,000		$12,000		$18,000		$15,000	
Total rent reserved		$100,000		$100,000		$120,000		$72,000		$72,000		$60,000
Annual rental value	8,000		4,000		4,000		4,000		6,000		3,000	
Total rental value		80,000		40,000		40,000		24,000		24,000		12,000
Total damage		20,000		60,000		80,000		48,000		48,000		48,000
Allowable claim		20,000		30,000		36,000		36,000		48,000		45,000
Destroyed claim		none		30,000		44,000		12,000		none		3,000

(N. B. The above figures are regardless of discount. Substantially similar results would be obtained if the figures for *Total rent reserved* and *Total rental value* were adjusted at the same rate of discount.)

of another are allowed for twenty years. A more arbitrary, unrelated standard could scarcely be imagined. It necessarily produces wholesale inequalities.

The Court of Appeals, although recognizing the gross inequalities produced by the statute as among different landlords, upheld the statute by a curious process of reasoning: the court thought (R. 154) that if Congress had limited landlords' claims to their *losses* for four or five years, *that would have been* reasonable, in view of the supposed unreliability of the formula used for measuring their losses; since ordinarily the limitation of claims to three years rent would permit landlords to prove their losses for at least four or five years, the complaint against the statute is merely that when a landlord's "losses are large he is not treated equally with those whose losses are small". The court concluded that since "no lessor is unjustly treated as against his lessee, this is a complaint to which we are not disposed to lend an auspicious ear", because "nobody should be shocked that in a class of claims like these, so inherently uncertain, a piepowder standard is chosen, even though it operates unevenly as unquestionably it does." The court also suggested that only "the lessee" could complain that some landlords might recover their losses for more than five years and that the lessee could not make this complaint because "he [*sic*] is getting a discharge upon a payment which he cannot show is too great until the occasion is past".

The Court of Appeals ignored the realities of the situation. It is inherent in any scheme of reorganization that every member of each class of creditors and stockholders should receive ratably equal treatment with his fellows in that class. But, under the statute as construed below, as we have shown, only

by the merest accident can any two landlords receive treatment ratably proportionate to their losses, whether presently appraised or subsequently ascertained. That is a complaint, therefore, which should be available to any landlord who does not participate to the full extent of his actual loss.

Moreover, the remarks of the Court of Appeals are relative only to a statute which Congress *might have enacted,* if it had desired to limit all landlords' losses to four or five years—not to the statute actually enacted (see *supra,* p. 28).

Even if ratably equal limitation of landlords' claims would be valid, that should not deprive any landlord of the right to complain that the provision actually enacted does not treat similarly all persons similarly situated but arbitrarily discriminates among members of the same class among whom there is no legal basis for distinction.

Moreover, the court's view that "no lessor is unjustly treated as against his lessee" was based entirely upon the assumption that a rough standard of justice must be applied because of the supposed difficulty of ascertaining the "future value" of real estate. To this there are two answers: first, it is a difficulty which affects only the question of whether the entire claim is *presently allowable* (*supra,* p. 22), and second, it is no difficulty even in that connection (*supra,* p. 19).

The statute produces other inequalities and arbitrary discriminations which the Court of Appeals entirely ignored.

The provision discriminates against landlords in favor of other creditors whose claims are equally difficult of evaluation. Claims based on contracts for

the future purchase or sale of personal property,* even though having no recognized market value; claims for loss of employment or destruction of earning power;** claims for personal injuries, defamation of character, mental suffering; claims for loss of profits due to patent infringement or unfair competition—these and many others, equally or even more difficult of liquidation, are not restricted for the benefit of stockholders.

Of even greater significance is the fact that there is no limitation on claims arising out of licenses (even where involving the use of realty)† and leases of personal property, contracts for the future purchase or sale of real property,‡ other indemnity contracts, or even *contracts guaranteeing the performance of a lease of real estate including a covenant to indemnify against loss of future rent* (*such a claim is not covered by the limitation provision*).

Even more—the claims of landlords of railroad and municipal corporations and of individuals are

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* The Court of Appeals held that the petitioners' claim should be "liquidated like a claim for breach of an executory contract for chattels." See *In re Susquehanna Silk Mills,* 10 F. Supp. 787, aff'd, 77 F. (2d) 1015. In his opinion in the *Manhattan Properties* case (66 F. [2d] 470) Judge Learned Hand said:

> "Certainly I have no more compunction in assessing the future value of realty, than that of chattels. The periods involved are indeed apt to be longer, but the fluctuations are less rapid."

** *In re Schultz & Guthrie,* 235 Fed. 907.

† *Central Trust Co.* v. *Chicago Auditorium,* 240 U. S. 581.

> "The uncertainties attendant upon any future installments [in that case] were as great as in the case of a covenant to pay rent under a lease." (Learned Hand, *C. J.*, in the *Manhattan Properties* case.)

‡ Judge Learned Hand said in the *Manhattan Properties* case:

> "The uncertainty as to the future value of a fee is no less great than as to the value of sequent terms."

allowable in full under Sections 77, 80 and 74 of the Bankruptcy Act. And in ordinary bankruptcy proceedings, while the landlord's claim is provable under Section 63(a), as amended, only up to one years rent, presumably no greater part of the claim is discharged.

Thus the discrimination against landlord creditors in Section 77B cannot be sustained as a valid classification based on the supposed difficulty of liquidating their claims (*cf. Quaker City Cab Co.* v. *Penna.*, 277 U. S. 389).

(2) The limitation provision deprives the petitioners of their property by legislative decree and without making a fair return.

The provision operates automatically—without regard to the condition of the debtor, the extent of the stockholders' equity or any other particular circumstances of the case (*cf. Lowden* v. *Northwestern Nat. Bank & Trust Co.*, 56 S. Ct. 696). The judge has no discretion as to limiting landlords' claims. A landlord is not permitted to show that, under the circumstances, it would be unfair to limit his claim for the enrichment of the stockholders of a solvent corporation. On the question of whether the limitation is fair and equitable under the circumstances the landlord does not have a day in court or a hearing of any kind (*cf. National Surety Co.* v. *Coriell*, 289 U. S. 426; *First Nat. Bank* v. *Flershem*, 290 U. S. 504, 525). "This is not legislation. It is a decree under legislative forms" (*Loan Ass'n* v. *Topeka*, 20 Wall. 655, 664). It is legislative usurpation of judicial power (*Louisville &c. Bank* v. *Radford, supra; Heiner* v. *Donnan*, 285 U. S. 312; *cf. W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426).

The petitioners are given no fair equivalent for the rights of which they are deprived. It probably will be urged that the amount of three years rent presently allowable (on a parity with provable debts) is more than fair compensation for the extinguishment of a right (subordinate to debts now allowable) to be indemnified for loss the amount of which, if any, is not ascertainable until the end of the term. The answer is that each case must be considered on its own merits; and Congress has no power to decree that the substituted remedy is in fact compensatory in every case (*cf. Heiner* v. *Donnan, supra; St. Joseph Stock Yards Co.* v. *United States,* 56 S. Ct. 720, 736-8).

The Court of Appeals reasons (R. 156) that, since the debtor was already in default and subject to dismemberment by its creditors, and the petitioners' claim was not yet suable, their rights against the debtor in the absence of reorganization would have been "no better than if it were out and out insolvent." This reasoning is similar to the argument which was unsuccessfully advanced in the *Boyd* case, that the assets involved in that reorganization were insufficient to pay the mortgage debts, leaving nothing of value for general creditors. In that case this Court said that the superior rights of creditors over stockholders "must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the balancing of evidence as to" the value of the property, and that if the value of the property justified the issuance of securities to the stockholders "the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control", since "in either event it was a right of property out of which the creditors were

entitled to be paid before the stockholders could retain it for any purpose whatever" (228 U. S. at pp. 507-8).*

Although Section 77B does not contain a severability clause, the unconstitutional provision may be stricken out, leaving the remainder of the statute as operative legislation (*In re Tennessee Publishing Co.*, 81 F. [2d] 463, 468).

Respectfully submitted,

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* There has been no finding that the debtor is insolvent nor has its insolvency even been alleged. There is no basis whatever in the record to support the assumption of the Court of Appeals that the amount of presently enforceable liabilities was so great that dismemberment would have resulted from their enforcement or that if all presently enforceable liabilities had been satisfied a surplus would not have remained which would have constituted a trust fund for contingent creditors such as the petitioners (*Pierce* v. *United States, supra; Block* v. *Bell Furniture Co., supra*). On the contrary, the active participation of a Preferred Stockholders' Protective Committee in the proceedings, as shown by the record, indicates the likelihood that a substantial equity exists over provable debts and the portion of landlords' claims allowable on a parity.